NATIONAL CREDIT UNION ADMINISTRATION

NCUA News

January 1999, Number 1

New Chartering Policy Effective January 1, 1999

For the first time in over two years, federal credit unions can once again expand their fields of membership and merge with non-affiliated groups effective January 1, 1999. The NCUA Board approved comprehensive changes to chartering and field of membership policies at its open meeting in Alexandria December 17, 1998.

The final changes implement the requirements of the *Credit Union Membership Access Act* (PL 105-219) signed into law August 7, 1998. The rule takes effect January 1, 1999, with the exception of the provisions defining "immediate family member" and well-defined "local community." These two provisions, designated by Congress as major rules and subject to congressional review, are expected to take effect March 5, 1999.

"This has been a momentous endeavor for the agency. We received nearly 400 comment letters from every interested party imaginable," said NCUA Chairman Norman E. D'Amours. "Overall, I believe we have a good product that will allow credit unions to continue operating safely and soundly, while offering more consumers the choice of obtaining credit union service."

The primary revisions concern NCUA's policy on various types of federal credit union charters and the criteria necessary to amend a credit union's field of membership. The final rule also clarifies overlap issues, mergers, low-income policies regarding low-income charters and service to underserved areas, the definition of immediate family member or household, and the "once a member, always a member" policy.

The new policy authorizes three types of federal credit union charters:

- single occupational or associational common bond;
- multiple common bond; or
- local community, neighborhood, or rural district serving a well defined area where residents have common interests or interact.

The major changes include:

Select Group Additions

Before an existing credit union can add a new occupational or associational select group with less than 3,000 potential primary members, NCUA must determine in writing that the following five statutory criteria have been met:

(1) The credit union did not engage in any unsafe or unsound practice that is material during the one-year period preceding the filing of the application;

(2) The credit union is adequately capitalized;

(3) The credit union has the administrative capability and the financial resources to serve the proposed group;

(4) The credit union must demonstrate that any potential harm the expansion may have on any other credit union and its members is clearly outweighed by the probable beneficial effect of the expansion; and

(5) The NCUA must determine that the formation of a separate credit union is not practical or does not meet the economic advisability criteria

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Economic Advisability Threshold

The NCUA Board has not set a minimum field of membership size required for chartering a new credit union. Consequently, groups of any size may apply and be approved for a credit union charter if they demonstrate economic viability. However, it is important to note that often group size is indicative of success. Therefore, a charter applicant with less than 3,000 primary, potential members may have to provide more support than an applicant with a larger field of membership.

Voluntary Mergers

The voluntary merger of healthy, multiple common bond credit unions containing select employee groups of less than 3,000 primary potential members is permitted without regard to the statutory analysis that is required when non-affiliated groups of less than 3,000 members seek to join an existing credit union.

Community Charters

In order for a credit union to receive a community charter, geographic area boundaries must be clearly defined; the applicant must establish that the area is a well-defined "local community, neighborhood, or rural district;" and the residents must have common interests or interact. A single political jurisdiction that does

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HIGHLIGHTS

Credit Union Gains Expanded Investment Authority

The NCUA Board approved, at a closed meeting in December, its first participant in an investment pilot program under Section 703.140 of the *NCUA Rules and Regulations (R&Rs).*

Within parameters approved by the Board, the participating credit union can acquire Treasury Inflation Protection Securities (TIPS). TIPS are a special form of Treasury security that indexes both the principal and the coupon payments to inflation using the Consumer Price Index (CPI). TIPS are currently prohibited by Part 703 of the regulations. Section 703.100 permits credit unions to purchase variable rate instruments that are linked to domestic interest rates. The interest rate for TIPS is linked to the CPI, which is not a domestic interest rate, making this an impermissible investment.

A credit union approved for participation in a TIPS pilot program is required to maintain certain records and institute a board policy designed to protect its capital should losses from TIPS trading exceed a certain threshold.

The investment pilot program was created to permit exposure to certain investment activities prohibited by Part 703, but permitted by the *Federal Credit Union Act*. A limited number of credit unions may be approved for participation in a particular program. As credit unions and NCUA gain experience with the activity, the NCUA Board may determine that it is appropriate for all credit unions, suitable for some credit unions, or inappropriate for all credit unions. Part 703 would be revised accordingly.

Section 703.140 of the *R&Rs* contains requirements for how a credit union may participate in the investment pilot program. Credit unions that wish to participate must submit a request to the appropriate regional office.

Revolving Loan Rate Set at 2 Percent in 1999

The NCUA Board reduced the interest rate from 3 to 2 percent on loans provided in 1999 through the Community Developing Revolving Loan Program (CDRLP). Loan applications will be accepted throughout the year.

Congress created the Revolving Loan Program in 1979 with a $6 million appropriation. In the last three years, another $4 million has been added to the program that makes below-market loans and offers technical assistance grants to qualifying low-income designated credit unions. The credit unions use the money to provide their members with basic financial and related services that result in increased income, ownership, and employment.

Since NCUA assumed responsibility for the loan program in 1987, the CDRLP has provided $19.8 million in loans to 100 low-income credit unions. As of November 30, 1998, outstanding loans totaled $7.7 million and delinquencies were zero. Based on repayment projections and the $2 million Congress added to the program in October 1998, approximately $3.5 million will be available for loans in 1999. CDRLP assets are now almost $10.8 million.

In addition, interest earned on the loans is used to fund a technical assistance grant program for low-income credit unions. To date, NCUA has provided over $1 million in technical assistance grants to participating credit unions. $200,000 is expected to be available for grants in 1999.

News Briefs

- Legislative Update — New Democrats on the Banking Committee in the House of Representatives are Frank Mascara (PA), Jay Inslee (WA), Jan Schakowsky (IL), Dennis Moore (KS), Charlie Gonzalez) (TX), Stephanie Tubbs Jones (OH), and Michael Capuano (MA). In the Senate, new Democratic Banking Committee members Chuck Schumer (NY), John Edwards (NC), and Evan Bayh (IN) replace Senator Moseley-Braun, who was defeated, and Senators Barbara Boxer and Tim Johnson, who are leaving the committee. Senator Phil Gramm of Texas is the new committee chairman.
- Prompt Corrective Action — An NCUA committee is developing the defining risk criteria and minimum net worth standards for complex credit unions along with initial guidelines and incentives for building capital for new credit unions.
- GAAP Reporting Revisions — The *Credit Union Membership Access Act* requires that credit unions over $10 million comply with GAAP accounting on reports required to be filed with NCUA. In 1999, NCUA will issue proposed revisions to the 5300 reporting form that meet GAAP.

NCUA News

NCUA News is published by the National Credit Union Administration, the federal agency which supervises and insures credit unions.

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Dennis Dollar, *Board Member*

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BOARD ACTIONS - DECEMBER 17, 1998

Proposed Bylaws Issued for Comment

The NCUA Board proposed new *Federal Credit Union Bylaws*, with a 90-day comment period, that delete outdated provisions, are written in plain, user-friendly language, and incorporate bylaws and standard bylaw amendments into a single manual.

The bylaws will remain a separate manual and will not be incorporated into NCUA regulations. Bylaws are a contract between an FCU and its members. Bylaws are used for internal governance and do not raise safety and soundness issues that require direct NCUA supervision.

Outdated bylaws have been eliminated based on a thorough analysis and input from credit union trade groups. While FCUs are required to use the bylaws published by NCUA, and the agency strongly encourages that credit unions adopt the revised bylaws, FCUs have the flexibility to continue to use previously approved FCU bylaws.

The Board is interested in receiving comments on the format of the proposed bylaws as well as any substantive issues the commenters wish to see addressed in the final bylaws.

TIS Rule Amended

The NCUA Board approved an interim final rule, effective immediately, with a 90-day comment period, amending Part 707 to implement statutory changes to the *Truth in Savings Act* (TISA).

The significant amendment provisions will:

- Permit disclosure of an annual percentage yield equal to the contract dividend rate for term share accounts with maturities over one year that do not compound interest but require at least annual dividend distributions. A statement is added to notify members that dividends cannot remain in these accounts.
- Eliminate subsequent disclosure requirements for automatically renewable term share accounts of one month or less. Credit unions must continue to provide disclosures when accounts are opened.
- Exempt all indoor lobby signs from certain advertising requirements.
- Repeal TISA's civil liability provisions effective September 30, 2001.

National Small Credit Union Programs Tabled

Two proposed national small credit union programs, offered for consideration as separate agenda items, were tabled for lack of concurring votes. In the vote to table one of the proposals, the Board voted 2 to 1 to eliminate the six new regional economic development specialist positions contained in the budget approved for 1999.

Supervisory Committee Audit Requirements Proposed

The NCUA Board issued proposed rule Part 715, affecting Supervisory Committee audits and verifications, to update current rules and incorporate the minimum audit requirements mandated by the *Credit Union Membership Access Act*. Issued with a 60-day comment period, the proposed rule specifies—

- Minimum annual audit requirements for credit unions according to charter type and asset size;
- Licensing authority required of people performing certain audits;
- Auditing principles, generally accepted auditing standards (GAAS) that apply to certain audits; and
- Accounting principles, generally accepted accounting principles (GAAP) that CUs must follow in *Call Reports* filed with NCUA.

Proposed Part 715 implements the statutory requirement that federally insured credit unions, with assets of $500 million or more, must obtain a financial statement audit performed in accordance with GAAS by a state-licensed individual. Credit unions with assets of less than $500 million (except FISCUs subject to a more stringent state audit requirements) can select from among three alternatives to fulfill their supervisory committee audit responsibility—

- A "balance sheet audit";
- A "review and evaluation of internal controls over Call Reporting"; or
- An audit under NCUA's Supervisory Committee Guide.

The proposal has a 60-day comment period.

Surety Bond and Insurance Coverage Updated

The NCUA Board issued a proposed rule, with a 60-day comment period, to codify and update regulations affecting required surety bond coverage for losses caused by credit union employees and officials and for insurance against losses caused by theft, holdup, or vandalism by people outside of the credit union.

The rule change designates Fidelity Bond and Insurance Coverage for Federal Credit Unions as Part 713 of the regulations. The proposal also corrects the cross reference in Section 741.201 to assure that state chartered, federally insured credit unions follow Part 713 requirements for insurance.

Eligible Obligation Rule Finalized

The NCUA Board approved a final rule amending Section 701.23, NCUA's regulation governing the purchase of eligible obligations.

The new rule clarifies that a federal credit union can purchase real estate loans from any source if it is granting real estate loans on a continuous basis and the purchase facilitates the packaging of a pool of loans for sale on the secondary market. The package must include a substantial portion of the FCU's own loans and must be sold promptly.

Safe Deposit Box Regulation May Be Eliminated

The NCUA Board issued a 60-day request for comments on a proposal to remove Part 701.30, regarding safe de

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Internship Program Gearing Up for 3rd Year

The unique internship program piloted by NCUA in the summer of 1997 to introduce minority college students to community development credit unions has gained momentum each year and is proving very educational for participant credit unions and the students.

In the two years since the program began, NCUA's Community Development Revolving Loan Program's technical assistance fund has committed a total of $40,000 to reimburse low-income credit unions (LICU) so they can provide small stipends, and cover housing and transportation expenses for their interns. The application period for the 1999 summer program is now open, and the Office of Community Development Credit Unions has begun the process of identifying credit unions and colleges interested in participating.

What makes the NCUA program distinct from other internships is that each student is exposed to two credit unions during the 12-week stint, a large credit union and a smaller, low-income designated credit union. Both small and large credit unions must be designated low-income. The LICU serves as the host credit union, while the other credit union is the mentor credit union. During the first two years of the program, the credit unions have ranged in asset size from $1 million to $200 million and presented very different operational challenges. The students learn every aspect of how to run a small credit union, from customer service to stuffing monthly statements to developing marketing plans.

Preparing Students For Management

The NCUA's primary goal in developing and continuing the program is to produce a pool of educated and trained professionals who will be ready to assume positions at small credit unions when experienced managers leave or retire. But if these CEO positions are not immediately available when students graduate, students will have enough experience to secure responsible positions at large credit unions.

"The biggest problem for small credit unions is a lack of resources; both human resources and monetary resources," according to Joyce Jackson, director of NCUA's Office of Community Development Credit Unions. "The program we developed is two-fold. It fosters mentoring between large and small credit unions, youth and local colleges and universities; while also training bright young people to become managers of a credit union," explained Jackson.

"Our intern was a delight - bright, eager to work and to learn. We exposed her to many jobs in the credit union. She immersed herself in all things connected with lending and collections, and especially enjoyed giving presentations to new groups," Joy Cousminer, manager of $3 million Bethex FCU, in the Bronx, New York, commented on her intern from the College of Staten Island.

According to Cousminer, one of the highlights of the student's summer was spending a Saturday in charge of a table at a local park fair where she had the opportunity to explain the advantages of credit union membership to many people who knew her. "As a result, Dalma was able to sign up a considerable number. She also did an evening presentation in the tenants' room of the building in which she lives, and was equally successful," said Cousminer.

Jackson says minority students, in particular, have told her that it is very difficult for them to secure responsible positions within their field of study once they graduate, unless they have this type of hands-on training and career mentoring.

This unfortunate reality recently caught the attention of some credit union trade groups. The Credit Union Executives Society (CUES) and Credit Union National Association (CUNA) recently announced that they will pilot a similar internship program beginning in 1999, which will place minority graduate students in large credit unions with assets over $100 million. Like the NCUA pilot of 1997, the CUES and CUNA pilot will recruit business majors from historically black colleges and universities (HBCUs).

According to NCUA Chairman Norman D'Amours, the impetus for the NCUA program was to expose young people to credit unionism and to expand and diversify the pool of qualified management candidates. "Young people have a valuable contribution to make to our society. They bring fresh ideas and an abundance of enthusiam to the table. We're thrilled that these trade groups also share our desire to reach out to minority students as well as other young people to train them to one day run credit unions," D'Amours said.

As an example, Chairman D'Amours recalled a recent visit to a low-income credit union in New York city where he was impressed with the group of young adults running the 2-year-old community credit union. Every member of the board of directors, supervisory committee and credit committee are under the age of 40, all have at least a bachelor's degree, and many have advanced degrees.

"They are an intelligent, highly educated and creative group of professionals who believe in their community and the credit union philosophy of teaching thrift and helping people do better. I was extremely impressed with their desire to make a difference," D'Amours said.

Mentoring Between Large and Small CUs

To participate in the NCUA program, students must be juniors or seniors majoring in a business discipline. A LICU applies

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Year 2000 - Remaining Challenges

Credit unions achieved significant progress during 1998 in preparing for Year 2000. *NCUA's Quarterly Congressional Update*, delivered to Congress in December and available on the NCUA Web site, reports that 94.2 percent of credit unions are rated "satisfactory" and only 35, or .3 percent are rated unsatisfactory.

During 1998, credit unions:

- Inventoried affected systems;
- Contacted third party vendors;
- Developed written Year 2000 plans, test plans and contingency plans; and
- Began renovation and testing efforts.

Despite the progress achieved, challenges remain. These challenges fall into 4 general categories as discussed below.

1. Renovation & Testing:

Credit unions should be nearing the completion of the Renovation phase of their Year 2000 project. This involves the upgrade and/or replacement of all non-compliant systems by no later than January 31, 1999. If a credit union will not be able to meet the January 31 deadline, the appropriate NCUA regional director must be notified in writing per *Letter to Credit Unions (*LCU) *98-CU-13.*

Also, credit unions should be demonstrating progress in testing critical systems based on one of the methods specified in LCU 98-CU-13. Full testing of all critical systems and interfaces must be completed no later than June 30, 1999. If a credit union is unable to meet the June deadline, the appropriate regional director must be notified in writing.

2. Year 2000 Communications

Effective Year 2000 communication to outside parties is essential to protect the credit union from undue legal liability, to ensure the credit union remains competitive, and to avert or reduce potential liquidity problems. An effective Year 2000 communication strategy contains the following elements:

- A written policy setting forth how the credit union will address this area.
- A thoughtfully drafted Y2K Compliance Statement to use in answering Year 2000 inquiries.
- Appointment of a media spokesperson to address any media inquiries and Year 2000 related crises.
- Staff training on how to respond to Year 2000 inquiries.
- An ongoing communication and marketing strategy to keep the membership informed of the credit union's status and to assuage any concerns..

3. Liquidity Planning

For a variety of reasons, including media coverage, consumers may make abnormally large fund withdrawals in late 1999. Credit unions should plan now for potential liquidity needs by:

- Developing a written plan to address liquidity needs, including how cash demands in excess of the available supply will be handled.
- Analyzing historical and seasonal cash needs and developing reasonable assumptions for increased demand related to the Year 2000.
- Preparing for additional cash needs by adjusting the credit union's investment strategy accordingly. Arrangements for committed lines of credit should be made when necessary.
- Arrangements for sufficient cash to stock proprietary ATMs, teller drawers, and the vault should be made. The surety bond company should be contacted to ensure appropriate bond coverage.

4. Business Resumption

Year 2000 could involve interruptions in power, telecommunications, and other essential utility services. It is essential that credit unions update and test their disaster recovery plans in 1999. Contingency arrangements for essential services should be made as early as possible. For example, if the credit union plans to rely on a generator in the event of an interruption in electrical service, the generator should be secured in advance and tested. Also, arrangements for adequate fuel should be made.

In coming months, NCUA will publish additional guidance in these areas to assist credit unions in Y2K planning efforts.

NEW CHARTERING POLICY

Continued from page 1

not exceed a population of 300,000 will be eligible for a streamlined application process. Additionally, multiple, adjacent political jurisdictions of 200,000 or less are eligible for the streamlined application process.

Community Service Requirement

Community credit unions will be expected to regularly review and follow, to the fullest extent economically possible, the marketing and business plan submitted with their application.

Immediate Family Member or Household

For eligibility to join a credit union, immediate family is defined as a spouse, child, sibling, parent, grandparent or grandchild, stepparents, stepchildren, step siblings, and adopted individuals. Household is defined as persons living in the same residence maintaining a single economic unit. This definition includes any person who is a permanent member of, or participates in, the maintenance of the household. After an immediate family or household member joins, then that person's immediate family would also be eligible to join. While a credit union can adopt a more restrictive definition than NCUA's, it cannot establish a more expansive definition.

Serving Foreign Nationals

NCUA has had a long-standing policy prohibiting the establishment of a federal credit union for the primary purpose of serving citizens of a foreign nation.

Under new NCUA policy, existing credit unions are permitted to serve foreign nationals within their fields of membership wherever they reside. However, credit unions that wish to serve foreign nationals who reside in a foreign country and who have never resided in the United States must first obtain written approval from their respective NCUA regional director. Service facilities can only be established outside of the U.S. if the service facility is located on a U.S. military installation or a U.S. embassy.

BOARD ACTIONS

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posit box service, as part of the agency's constant effort to update and streamline agency regulations. Offering safe deposit boxes is part of the routine services that FCUs can provide and requires no separate regulation.

Nonmembers Can Assume Member Real Estate Loans

The NCUA Board approved a final amendment adopting the agency's long-standing interpretation that federal credit unions can permit a nonmember to assume a member's long-term, residential real estate loan when a nonmember purchases a member's principal residence.

Charter and Insurance Conversions

The NCUA Board denied the appeal of **Resource 1 FCU** to convert from a multiple group to a community charter serving the two million residents of Dallas County, Texas. The 45,000-member, $144 million credit union is based in the city of Dallas.

The Board approved a request from **Family First FCU,** Orem, Utah, to expand its community charter to serve the 298,789 residents of Utah County. The $50 million credit union currently serves the city of Orem and unincorporated Utah County.

CDCU INTERNSHIP

Continued from page 4

for a technical assistance grant to fund an intern. If approved, the LICU is paired with a non low-income credit union. The LICU contacts a college near its operation, interviews and selects a student identified by the school's internship coordinator.

The 1997 pilot brought together four minority students from three historically black colleges and universities (HBCUs) with eight credit unions in the South and in Washington, D.C.

Jackson expanded the program during the summer of 1998 to include five students from HBCUs and nine from other colleges and universities around the country. The 14 schools represented spanned the country: Alabama, Arkansas, Louisiana, Montana, New Mexico, New York, Oregon, South Carolina, South Dakota, and Vermont.

"The performance of our summer intern exceeded our expectations. She was a quick study, eager to learn, punctual, and diligent in her approach to her training," commented David Knapp, CEO of $10 million Railway Employees FCU, Tucumcari, NM. "The [internship] program was both cost effective and educationally beneficial. It was also helpful to both the host and partner credit unions in offering us needed personnel assistance through the summer... during a heavy vacation schedule," Knapp noted.

"The NCUA internship provided a helpful summer marketing assistant through the Rochester Institute of Technology, and forged an important supportive relationship with The Summit FCU," commented Michael Walker, board president of $3 million Genesee Co-Op FCU, in Rochester, New York.

"The internship offered by the Office of CDCUs proved to be an excellent experience for VDCU," wrote Jeff Smith, from $4.7 million Vermont Development Credit Union, in Burlington. "The program provides CDCUs with another tool to recruit individuals into their organizations. Mr. Ryan's work proved to be critical to the operations of the credit union. Upon his departure, we incorporated his duties into a new position," said Smith.

Jackson says the CDCU Office expects to approve funding for 25 student interns to train in 50 partnered credit unions for the summer of 1999. Low-income designated credit unions will be receiving applications in the mail soon. Large and small credit union partners are needed. Credit unions interested in participating should call (703) 518-6610.

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STRUCTURING DIVIDENDS

Pricing Dividend Rates Effectively

Many managers, asset liability committee members, and credit union directors set share dividend rates soley based on local competition rather than on affordability. As a result, it becomes difficult for these credit unions to determine their optimum, or most efficient pricing structure.

Competition is certainly an important factor to consider; however, credit union earnings and capital accumulation goals are even more important. To properly manage the liability side of the balance sheet, senior credit union staff must have a plan. As part of the plan, management must first be able to identify core (i.e., non-maturity) share deposits before determining optimum pricing strategies for the rest of the credit union's product mix.

Core share balances are usually characterized as being stable and insensitive to external market rates or alternative investment choices. However, a core share balance will differ from one credit union to another based on factors such as demographics of the field of membership (community charter versus one industrial sponsor), size of average share accounts, size and mobility of population centers, average age of members, and many other factors.

One goal of an informed management team should be to effectively balance the needs of the membership with the ability to identify the lowest rate that can be paid on core accounts to help meet earnings and capital goals. At the same time, management must avoid adverse changes to the balance sheet composition and not interfere with the credit union's liquidity position.

With other products, such as money market accounts, IRAs, and certificates of deposit, management should continuously monitor the credit union's desired net interest margins and resulting net income position. Simply put, the net interest margin (interest on loans and investments minus cost of funds divided by average assets) plus fee income must be sufficient to cover the credit union's operating expense ratios (including provision for loan loss expenses) to maintain and build capital.

Solely basing rate structures on competitor's rates can be detrimental and a inefficient use of member funds. Senior credit union staff must adhere to a sound asset-liability management strategy to provide the membership with the most efficient mix of products, effective rates for shares and loans, and cost-effective services while building a strong capital position to provide flexibility in difficult times.

Nov. 20, 1998 — Michael Palladino, president and CEO of First New England Federal Credit Union, welcomes Board Member Dennis Dollar (right) to the East Hartford, Conn., credit union.

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